RICHARD RUSSELL'S **DOW THEORY LETTERS, INC.**

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May 18, 1983 **LETTER 861**

May 6 DJIA 1232.59; PTI 1621; A-D Ratio -13.10
May 13 DJIA 1218.75; PTI 1622; A-D Ratio -12.84

THE MARKET: What's behind the astounding performance of the stock market? A few items that come to my mind are (1) The breakout of the major averages from a 17 year "trading range". (2) The tide of new cash pouring into the mutual funds. My old friend, Marty Zweig (747 Third Ave., NYC 10017) points out that over the past 11 years the funds suffered a cash outflow of $10.5 billion. BUT, over the past 9 months the mutual funds have taken IN a fantastic $5.5 billion. (3) The new IRAs, which are compounding on a deferred tax basis, are bringing in billions in new cash to the stock market. The effects of this new cash in-flow are massive. (4) The US bull market is part of a world-wide phenomenon. Stock markets across the face of the Free World are booming. Which indicates, as I have so often stated, that this is a primary tidal move. Primary movements are always *international in scope.* (5) The giant stock market rise has been unexpected. The public was not positioned for it. Thus, equities were "under-owned", and the public now finds itself with cash on its hands chasing a rising stock market. (6) Skepticism regarding the market has grown even as the major averages have surged higher. The short interest on both the NYSE and the AMEX hit record highs on the latest reading. Currently, most advisories are more concerned (and this has gone on for months) about "avoiding the coming correction" than they are about being invested in this primary bull market. (7) Robert Rhea wrote that "neither the duration nor the extent of a primary movement can be predicted in advance." Most analysts have forgotton these wise words. Experts have been calling for an end to this move, based on the experience of the past. But that simply has not worked so far. Never has the Dow risen 450 points without a correction. So I am reminded of another adage which I often repeat for my subscribers: "The stock market can do ANYTHING." (8) The stock market does not operate within a vacuum. As far as the market is concerned, the past is history. And the present is history as well. But the stock market isn't interested in history–it's interested ONLY IN TOMORROW. It seems to me that the markets are forecasting a coming boom. They are adjusting themselves to dramatically better times. Those times may not appear until the second half of 1983 or even until the final quarter. We have trouble even envisioning boom times today. But the markets are saying that they are coming. (9) Finally, and people tend to forget this, a rising tide of stock prices has to affect the general prosperity of the nation. I just checked on the Wilshire Index (5,000 stocks covering the value of all the NYSE, all the AMEX and a good deal of the O-T-C), and the value of the Wilshire is $1.743 trillion. That means that the value of all stocks is up a mind-blowing $681 billion or a percentage rise of 64%. Now that huge amount of appreciation has to affect the prosperity of the nation. People have to feel richer. And that feeling will undoubtedly have a highly positive effect as the year draws on.

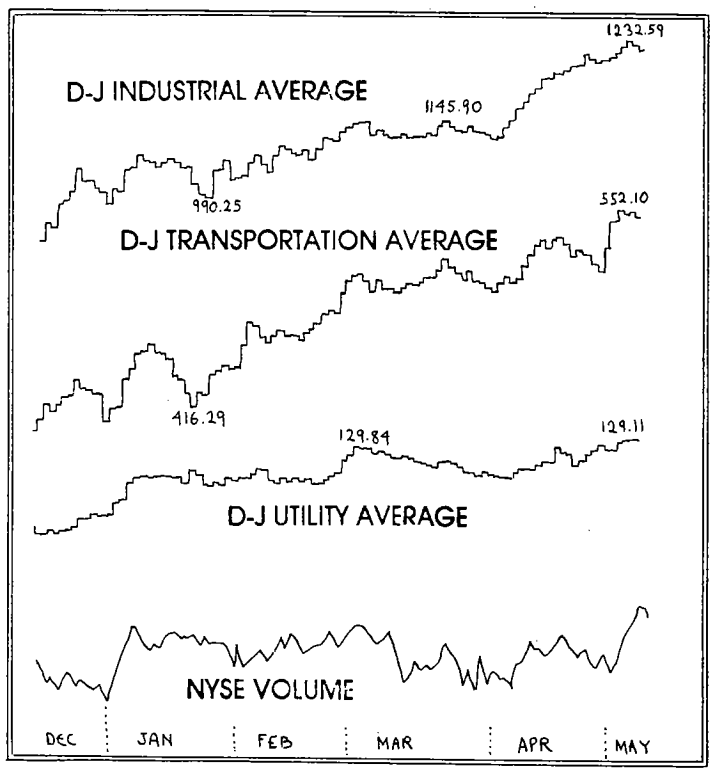
Subscribers know that I always place a lot of emphasis on the direction of the short interest during a primary bull market. There is nothing more bullish than an established primary bull trend that is being fought by the bears. One of the best gauges of bear action is the short interest on the NYSE. For that reason, I would say that any further increase in the short interest (to be released around May 20) would be explosive in its implications.

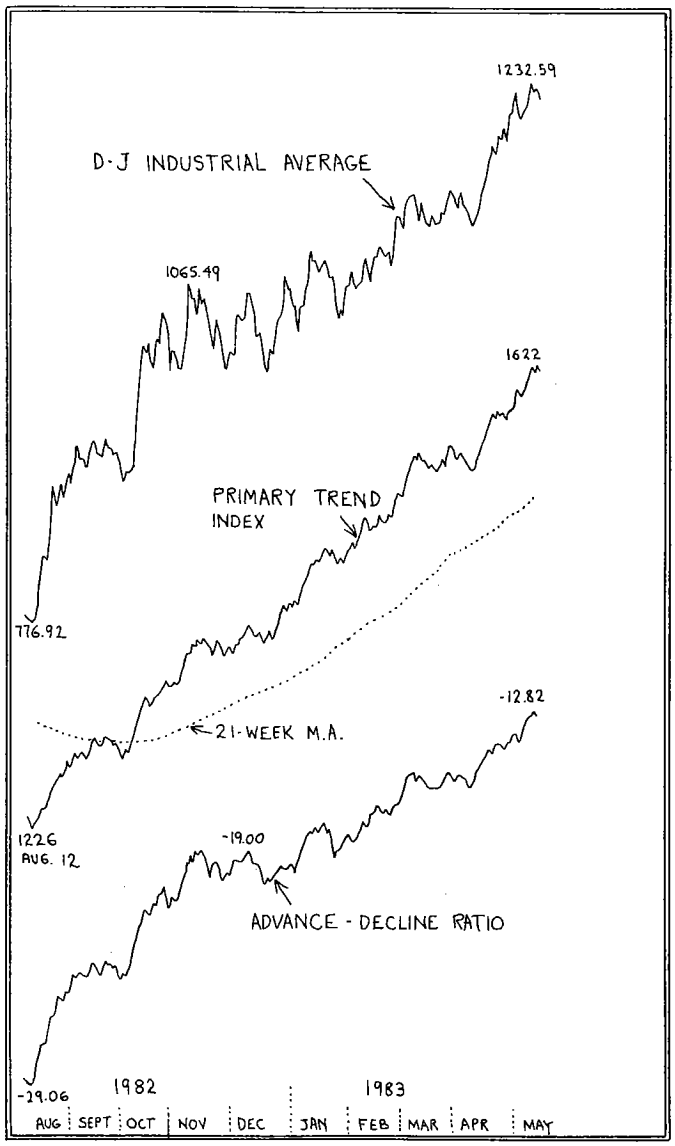
Marty Zweig monitors what he terms the Total Short Interest Ratio which is all short sales divided by NYSE volume. Marty notes that this data (recent week) jumped to 10.82%, highest since "the October leg of this bull market took off." He notes that there were only five higher scored in the past dozen years, and all of these had bullish implications.

PTI: The Primary Trend Index is my "mystical" composite indicator. The PTI measures the cumulative technical strength or weakness of the market. Each day I compute the PTI, and I then graph the new figures on a chart along with the Dow and the A-D ratio.

I don't know exactly why (obviously it's in the construction) but the PTI tends to move along beautiful trendlines for extended periods of time. For instance, if you examine the chart of the Dow, the PTI and the A-D ratio, it is immediately apparent that the best and most consistent rise has been made by the PTI. From its 1226 low of August 12, the PTI has walked steadily up a rising trendline. That trendline was tested in three different instances, but each time (upon making contact with the trendline) the PTI bounced upward–to new highs.

Now it's an awful lot to ask of any item to hold above a trendline for nine consecutive months, but that's exactly what the PTI has done. To allow it some leeway, I also run a 21-week moving





average of the PTI. The PTI moved above the 21-week MA last October, and it has never looked back. From an investment standpoint, I would pay close attention if the PTI broke below its rising trendline, but I would nevertheless consider the trend up as long as the PTI held above its 21-week MA.

Let me put it another way. As I've stated in recent Letters, you have to give a big primary bull market a lot of leeway. You can't examine it with a magnifying glass. You can't pick out every little divergence, every daily non-confirmation, every change in sentiment and announce, "This is it–run for the hills." A primary bull market such as this one builds up momentum, it has a tremendous force behind it, and it's not going to be stopped by a two-day divergence.

INVESTMENT POSITION: I'm getting a bit tired of saying this–but this is a "buy and hold" market. We are witnessing what I term a "once-in-a-lifetime" bull move, and to trade this move is to take a very good chance of being left behind.

To my mind, the best (and easiest) way to invest in this market is through mutual funds. The direction of the market is up–but I suggest that you allow the professional to pick the stocks. All the odds (based on typical action) say that a correction should be upon us. But what everyone knows doesn't always happen on Wall Street. Everyone knows the market is "overdue" for a correction, and everyone knows that May-June is correction time. Let's see. . . .

For newer subscribers who have not moved yet, the following no-load mutual funds are suitable for purchase: Fidelity Equity Income Fund (800) 225-6190; Lindner Fund (314) 727-5305; Value Line Income Fund (800) 223-0818 in NY (800) 522-5217.

Gold: If you don't own gold or gold shares, sit tight. Buy if spot gold moves above 452 (which would BEGIN to be impressive).

"TRASH MARKET" OR MAJOR BULL? I seldom quote other services, but I will now because I want to illustrate this story.

"In my documenting what historians will see in retrospect as the most dangerous posture the market has been in since the summer of 1929, I add to this documentation by citing the two major articles that appeard in the Sunday New York Times entitled. . ." Granville Market Letter, April 30, 1983.

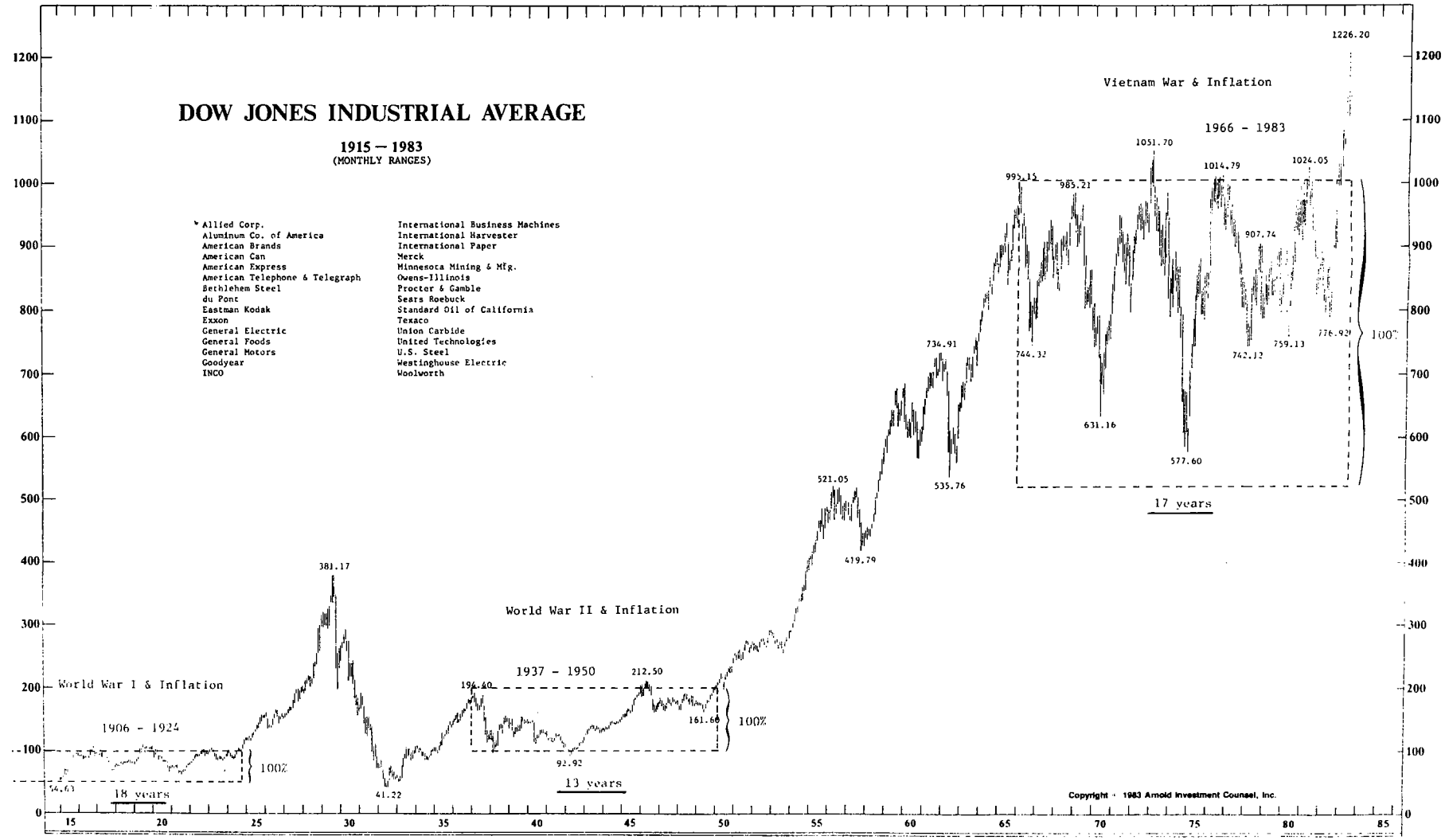
"On a longer term basis, the main drag on the economy is the government. It is not only that the government does so many things wrong, the cost of supporting the bureaucracy on its present scale is stupendous. The gross Federal debt alone stands at $1.249 trillion. The interest on this debt is a substantial part of the budget. Like some banana republic we are not only borrowing year after year to pay the interest, we are increasing the size of the budget deficits at a demented pace." Juncture Recognition, April 28, 1983.

"What we are seeing today is a phenomenon unprecedented in its scope. It will be examined and re-examined and written about over and over again in the 21st century. The subject will be the collapse of the world monetary structure. It is on its way. . . . The Dow Jones may go through 1200. It may go through 1300. But the higher it goes, the greater the crash will be and the greater the violence of its smashing repercussions." Myers Finance & Energy, April 29, 1983.

I read what these sincere gentlemen are writing, and I can relate to them and what they think and say. But frankly, I'm too steeped in the markets to accept those concepts fully.

"C'mon, Russell," you object, "you were writing about the debt build-up almost before anyone else. You were saying that the debt was going to climb to the moon, and that interest rates were compounding along with the debt. What's happened to change your attitude?"

And my answer is this: "Remember, all during the time that I was writing about the debt, the Dow was locked into the 16 year trading range of 1000 and below. All during that time the 1000 level was labeled "the graveyard in the sky." But now we have a totally different situation. The market has finally spoken. The Dow climbed decisively above 1000 this year, it then climbed decisively above 1100 for the first time in history, and next it spurted into the area above 1200. Thus, the 16-year trading range has been broken, and the graveyard in the sky (Dow 1000) should become a support area–and base."



This extraordinary chart is included through courtesy of "The Primary Trend", First Savings Bldg., 700 N. Water St., Milwaukee, WI 53202. I include it because I feel it adds perspective to what we are seeing now on Wall Street.

In the history of the averages, there have only been three "consolidation areas" of 13 years or longer. This chart shows those periods rather dramatically. The first period occurred during 1906 to 1924 (18 years), during which time the Dow fluctuated between 117 and 54. When the Dow finally broke out of this range it advanced to the 1929 high of 381.

The second massive consolidation occurred between 1937 and 1949 (13 years), with a Dow range of 212 to 92. When the Dow ultimately broke out of this range (during 1950) it advanced to a final peak of 1051 in 1973.

The third consolidation occurred for the Dow between 1966 and 1983 (17 years), and the Dow moved within a range of 1051 to 577. This year (1983) saw the Dow burst out of the range, and so far the high for the Dow has been in the 1230 area.

But I am trying to get over two basic points at this time. (1) The breakout from the 17 year consolidation period indicates that this is a different kind of primary bull market than anything most Wall Streeters have seen (unless you were in the market during the early 1960s). (2) An ultimate doubling or even tripling of the Dow is possible during the period ahead. There is precedent for that statement, based on the performance of the Dow (upon breaking out of long consolidation ranges) in the past.

On top of that, all the major averages and indices have confirmed the Dow by rising into record high ground. The PTI, which told the story all along, is pushing to record highs. And I feel that if one has any belief in the wisdom of markets, one has to believe that this market is telling us a bullish story.

From another aspect the picture is interesting. The initial thrust of a move often provides hints (measurements) as to the *extent* of the move. The bigger the initial thrust, the greater the ultimate bull market. The initial thrust of this bull market has already been around 450 Dow points. Remember, there has been no full correction of the rise since August, 1982, so we must accept the entire rise so far as the *initial thrust.* On this basis, the 3600 Dow target (Elliott) espoused by Bob Prechter may not be so far off. I place the odds for a 3600 Dow at around 50/50.

Conclusion: I tend to believe this market. I don't want to fight it, I don't feel inclined to denigrate it. The rise to record highs has been confirmed by almost every indicator in the technical book.

But what if there is real trouble ahead? What if this is the market's final flight to madness? How can we trust the market to steer us right? My answer is that aside from "selling too soon" (and maybe way too soon) there's no way to be totally safe from disaster. But I would imagine that this market will provide danger signals when the end is near. Furthermore, I feel that I can trust the PTI to tell us when the trend turns down.

I can't prove it, but intuitively I feel that there is more danger in exiting the market too soon than there is in "going over the top" and then down, down, in the abyss of a primary bear market.

GOLD/COMMON STOCKS: I have a very large number of what I term goldphiles or gold-bugs among my subscribers. In fact, I would guess they number in the thousands. But my job is not to feed any special group's particular ego. No, my job is to present the facts and to present my opinions.

When it comes to gold OR the stock market, there's little need to debate, complain or beat the drums for either investment. Why is this? Because a single chart can document where an investor should be.

Now it's important to differentiate between a core ("survival") position in gold and a major position in gold. When gold broke down in February, I stated that I thought gold, at best, would be "uninteresting" for months to come. Further, I stated that I thought "the place to be" would be the stock market. This chart attests to that opinion (chart courtesy of subscriber John Carder).

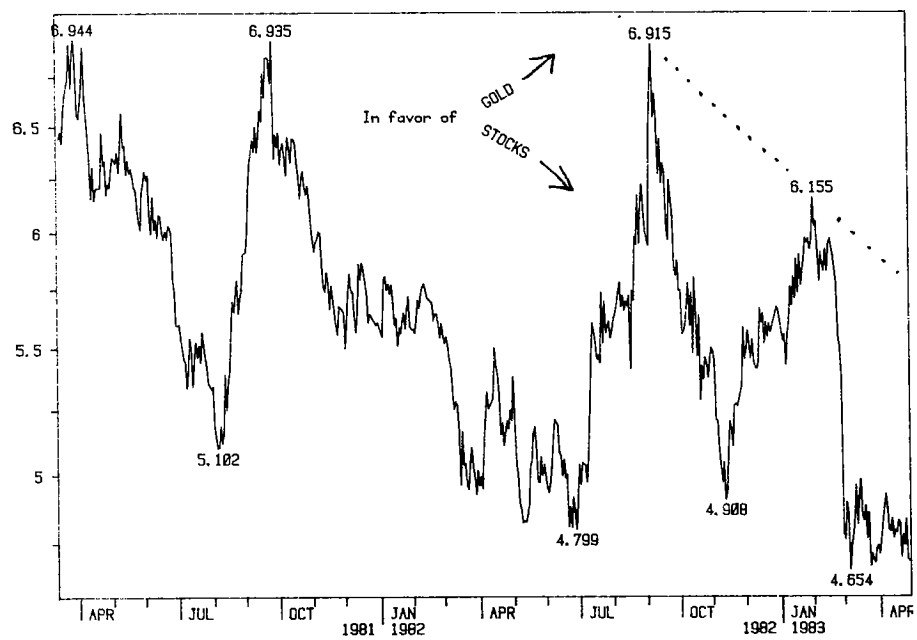
Here we see London gold divided (daily) by the value of the NYSE Composite Average. This becomes a relative strength chart. When the ratio rises, relative strength is increasing in favor of gold. When the ratio is declining, relative strength is increasing in favor of common stocks.

What we see here is four declining ratio peaks starting with the 6.944 peak of April, 1981 down to the 6.155 peak of January, 1983. Then we see a series of declining bottoms, the latest being the 4.654 bottom of March, 1983. What this series is telling us is that relative strength has been increasing in favor of common stocks over gold, at least through to April (and May) of 1983. In other words, on a cold reading of the chart the place to be was in common stocks.

Now this, of course, could change. In the last Letter I published a chart which showed the inflation/deflation balance. If that chart turns up in favor of inflation, then gold is most likely to move to higher levels. In which case, stocks could be hit and gold could be in the driver's seat. Should that occur, I would be the last to fight the changing trend.

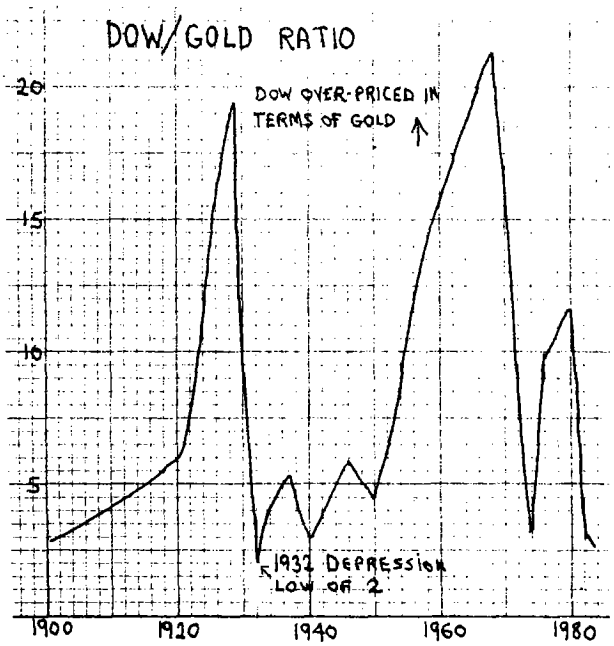
So the two charts will be monitored carefully. I feel it's critical to keep an open mind regarding the whole delicate inflation/deflation situation.

In Barron's (May 2) there is a most interesting letter comparing gold's price over the years to the price of the Dow. The author notes that in the early 1920s when the Dow stood at 100, each share of the Dow could buy roughly five ounces of gold (see my chart, pg. 5). At the 1983 Dow lows, each share of the Dow could buy only two ounces of gold. In 1933 gold was revalued to $35 and the stock market moved higher. But it was not until the 1980s that the one share of the Dow to two ounces of gold was reached again.



LONDON GOLD PM / NYSE COMPOSITE AVERAGE

It is fascinating to realize that last August when the Dow was 776 and gold was around 400 the old Depression ratio of roughly 2 was reached again. Now, nine months later, the Dow/gold ratio is still only 2.8 (one share of the Dow will buy roughly 2.8 ounces of gold). Note on the chart that during the 1960s a share of the Dow could buy anywhere from 20 to 25 ounces of gold. At that time, the stock market was vastly over-priced in terms of the yellow metal (or, to put it another way, gold was dirt cheap in terms of the stock market).



What of the present? Considering that the Dow/gold ratio is currently near 1932 Depression levels, it would seem that stocks are still dirt cheap in terms of gold. Or, gold is very over-priced in terms of the Dow. At any rate, the Dow/gold ratio has a long way to go if it is to come even close to the levels of the 1960s.

For example, suppose the Dow/gold ratio was to climb back to 10 or even 15? That kind of thinking gives credence to the Elliott target of 3600 on the Dow towards the end of the 1980s (see Letter 859, page 1). In all, the Dow/gold concept is a fascinating one at this stage of the bull market.

COMING: IN THE NEXT Letter I will include some startling information based on current conversations with Mr. Melvyn Lippman of US Organization Chart Service (he's my military expert, and a man who has access to an incredible amount and variety of military information). Also, I will include a second list of a few additional military-oriented stocks (as you can see, the first list of ten military stocks is doing very well).

		2/25/83 Price	Current Price	
NYSE	Harris Corp. (HRS)	49 1/2	44 3/8	Defense stock average based on 1 share of each this week is 309
NYSE	LFE (LFE)	11 7/8	16	
NYSE	Planning Research (PLN)	14 3/8	18 3/4	
NYSE	Scientific Atlanta (SFA)	19	18	
NYSE	Tracor (TRR)	28 3/4	33 1/4	
AMEX	Bolt Beranek (BBN)	37	55 1/8	
AMEX	BDM (BDM)	43 1/2	80	
AMEX	Dynalectron (DYN)	12 3/4	13	
AMEX	Moog B (MOGB)	15 1/2	19 1/2	
AMEX	Systems Planning (SPZ)	7	12	
	Original purchase date Feb. 25 '83		239	

Coming in the next Letter–three or four additional defense stocks to be added to this list!

NOTES & QUOTES: You love to trade, so why not commodities? No particular reason, except that it's an easy way to lose your shirt. The latest issue of *Commodities* magazine (May) has a rundown of the leading major public commodity funds (all these funds are run, of course, by professionals). In all, 59 funds are listed. Of the 59, 35 have lost money during 1983 so far. Of the 59 funds, 8 have lost 25% or more of their capital. And 21 of the 59 funds have lost more than 10% of their capital so far in 1983. So much for the professionals. How do you, as an amateur, feel you can do in commodities? My own advice is–go to Vegas, it's faster and you don't have to worry about commissions (although, of course, the house has its own take).

* *

Town and Country magazine has a section on the "Best of the New Luxury Imports". You remember how I raved about my new Datsun Maxima. Well, I'm still raving about that car. The incredible thing about the Maxima is that although it has a lot of sophisticated features, EVERYTHING WORKS. I still can't believe it. Here's what Town and Country says about the Maxima:

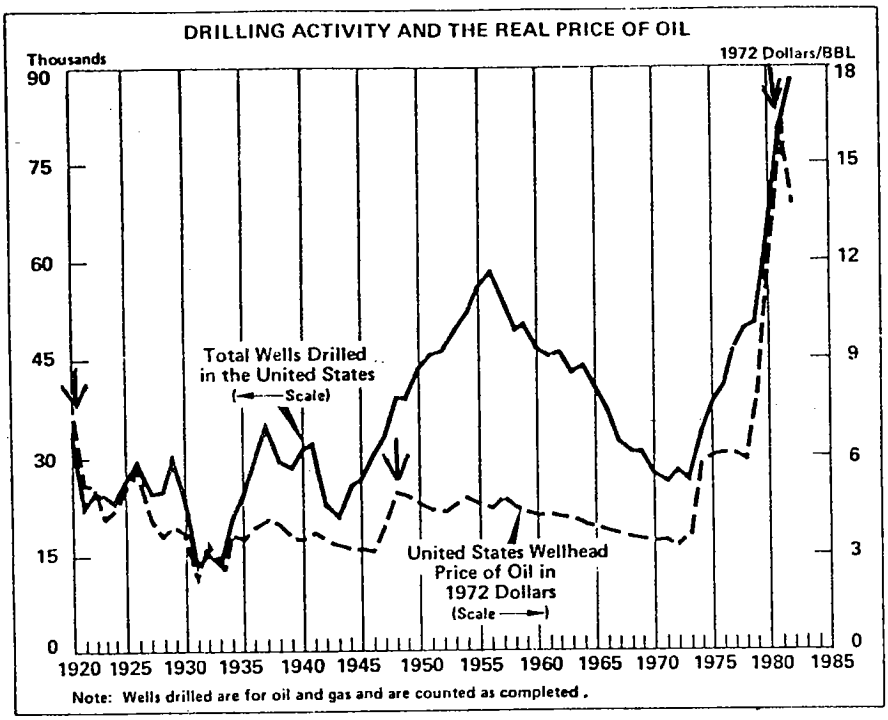
> DATSUN/NISSAN MAXIMA
>
> Some years ago in these pages we speculated that if Japan ever decided to build big cars, Detroit had better watch out. Oddly, what actually has happened is that U.S. cars have been getting smaller while some Japanese ones have been getting bigger. The result is the same. Here is a mid-sized, extremely well-equipped, utterly dependable family car that's as well finished as any U.S. car costing two times as much. If you need to be shown why imports are doing so well, go and see this car. $10,869.

Of the Toyota Supra, T & C says, "This car is so good that most people don't believe it until they try it." Of the Jaguar Vanden Plas, "Last year we called the Jaguar XJ-6 the best luxury car in the world, and now they've gone and upgraded it." Personally, I think the Jaguar (compared to the Mercedes) is a bargain.

GOLD: Most of the arguments for a higher gold price are well known. They are (1) The shakiness of the international banking system. (2) The possibility of a major default from one of the less-developed nations. (3) The possibility that the worst has been seen in the oil price (a higher oil price would be inflationary and good for gold). (4) The recovery (but not much of one) in the price of the commodity index. (5) The possibility that the 5.5 year cycle in gold has bottomed. (6) The possibility that the Fed will ease up even further as it guns the economy, preparatory to the 1984 election. (7) The fact that the gold shares have been performing well, and this should be a preamble to a higher price for the metal.

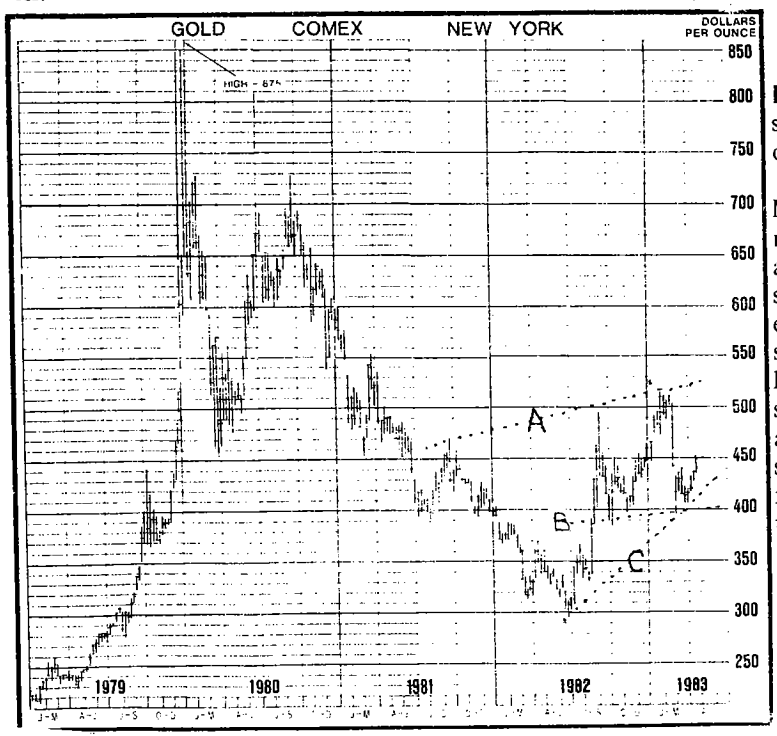
On the other side, a few observers believe that we are in the early beginnings of a long deflationary cycle. The cycle will be mild at first (dis-inflationary), and the stock market will love it (which it obviously does). But after a few years of mild deflation, the situation will turn ominously deflationary. that will end the "polite period" and usher in a deflationary collapse in almost all the markets.

A few weeks ago I received a very interesting letter from a Canadian subscriber. A chart was enclosed showing the price of


DRILLING ACTIVITY AND THE REAL PRICE OF OIL
Thousands
1972 Dollars/BBL
Total Wells Drilled in the United States (Scale)
United States Wellhead Price of Oil in 1972 Dollars (Scale)
Note: Wells drilled are for oil and gas and are counted as completed.

oil (and total wells drilled) over 65 years since 1920. The chart (page 6) shows three upward surges in the price of oil. The first upsurge peaked in 1920, the second in 1948 and the third probably in 1981. Following the 1920 and 1948 peaks, "real" oil prices declined for 25 years. The writer suggests that following the 1981 oil peak we could have another long declining price situation for oil. Time will tell.

I include a chart here from Kidder Peabody, a chart that illustrates the oil phenomenon from 1920 to the present. No one can examine this chart without wondering whether the latest down-arrow (1981) won't set off the kind of long, tedious decline that followed the two previous peaks in the wellhead price of oil.



	Dow	PTI	Gold
Current	1218		441
5-wk MA	1206		436
13-wk MA	1160		438
50-wk MA	1037		427
3-wk MA		1611	
8-wk MA		1581	
21-wk MA		1521	

Technically, gold seems to be walking a technical tight-rope. This chart (courtesy Commodity Research Bureau) provides the longer-term picture. If we look at just trendline A, it would seem that gold has been building a potential head-and-shoulders bottom–with a major up-side breakout coming if gold can rise above 525.

But suppose we ignore trendline A and only take trendlines B and C into consideration. Trend-line B, at roughly 400, indicates a potential head-and-shoulders top. If gold broke down below 400, the top would be completed and gold in that case would probably test the lows near 300.

Trendline C contains the entire rise from the 1982 lows. On a daily chart, I would say that a breaking of 430-425 would serve to rupture trendline C. If that occurred, I would consider the gold picture to be tipping strongly towards the bear side–with the odds favoring a topping out of the metal.

So there it is–a technical puzzle with gold capable of going either way. I'm not going to try to outguess gold. But I do note (1) an awful lot of bullishness about the metal and about the gold shares, (2) the gold/common stock ratio is negative for gold, (3) the gold/bond inflation/deflation ratio continues to be neutral to down for inflation, and this is another negative for gold.

LATE NOTES: Market action appears a bit tired, but it's still a primary bull market, and if you think you can out-smart or out-trade it–good luck.

My defense stock list originally appeared on February 25 or roughly three months ago. This week the list closed at 305, a gain of 27% in three months! I know that a great many subscribers immediately bought this list across the board or in equal dollar amounts. I've been urging subscribers in each Letter since February 27 to buy the list. And I'll say it again–buy the list now–across the board. Buy 10 shares of each, buy 100 shares of each, buy 1000 shares of each, buy equal dollar amounts of each–but buy them! These are some of the top sub-contractors in the coming space boom. These stocks are for the long term, they are not to be traded. Buy them, hold them, do not trade them. Do it! It's not too late!

NEXT MAILING: June 2